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David L. Gladwell v. Douglas James Reinhart : Brief of Appellee

Utah Supreme Court

IN THE UTAH SUPREME COURT

In re DOUGLAS JAMES REINHART, Debtor.	**REPLY BRIEF OF APPELLEE**
DAVID L. GLADWELL, Trustee, Appellant, v. DOUGLAS JAMES REINHART, Appellee.	Case No. 20110257-SC United States Court of Appeals Tenth Circuit Case No. 10-4075 (U.S. District Court No. 2:06-cv-00325)

ON CERTIFICATION FROM THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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I. UTAH CODE ANN. § 70C-7-103 CREATES A WAGE EXEMPTION IN BANKRUPTCY

A. Even though the Utah Garnishment Statute is Similar to the Federal Garnishment Statute, this Court Should Not Adopt the U.S. Supreme Court's Reasoning and Holding from *Kokoszka*.

The Trustee argues that this Court should change Utah's long standing tradition of protecting debtors' wages in bankruptcy, and instead should adopt the U.S. Supreme Court's reasoning and holding from Kokoszka because of the similarity between Utah Code Ann. § 70-7-103, and the federal garnishment statute, 15 U.S.C. § 1672(c) under the Consumer Credit Protection Act ("CCPA"). The Trustee focuses much of his first point on the Congressional intent of the CCPA and the U.S. Supreme Court's analysis of Kokoszka v. Belford, 417 U.S. 642, 644 (1974), to conclude that the Court should find that the Utah statute does not create a bankruptcy exemption. The Trustee's argument, however, is flawed.

A state can mirror a federal statute without mirroring Congressional intent. See Yaden v. Robinson (In re Robinson, 241 B.R. 447, 451 (B.A.P. 9th Cir. 1999)); Forker v. Irish (In re Irish, 311 B.R. 63, 66-67 (B.A.P. 8th Cir. 2004)); In re Jones, 318 B.R. 841, 847 (Bankr. S.D. Ohio 2005); In re Urban, 262 B.R. 865, 869-71 (Bankr. D. Kan. 2001)). Moreover, in this context, the CCPA provides a floor, and each state is free to provide more protection to debtors. See Brown v. Com, 40 S.W.3d 873, 877 (Ky. Ct. App. 1999); 15 U.S.C. § 1677. Therefore, a

state can provide exemptions where the federal statute does not. If a state has opted out of the federal bankruptcy exemption scheme, the state has plenary power to create its own exemptions and has no requirement to interpret those exemptions the same way Congress or the Supreme Court have done, regardless of their similarity. See In re Weinshank, 406 B.R. 413, 420 (Bankr. S.D. Fla. 2009); See also 15 U.S.C. § 1677(1) (CCPA "does not annul, alter, or affect...the laws of any state (1) prohibiting garnishments..."). Utah has clearly indicated that it wished to create its own exemptions as it opted out of the federal exemption statute. See Utah Code Ann. § 78B-5-513. Therefore, regardless of whether the Utah statute has nearly identical language to CCPA, the Utah statute should be interpreted based on state legislative intent and case law, not federal.

The Trustee stated that "[m]ost other courts to face this issue side with the Supreme Court in Kokoszka". Aplt. Brief at 11. However, those decisions are easily distinguishable from the case at hand. For example, in Smith v. Frazier the court analyzed whether the *federal* garnishment creates a wage exemption, not whether a similar state statute does so. See Smith v. Frazier, 421 B.R. 513, 516 (S.D. Ill. 2009). This differs from the present case since the Court has been asked to analyze whether state law creates an exemption under the Utah statute, not whether federal law does so.

In two other cases cited by the Trustee, the courts held that wage exemptions did not apply in bankruptcy because there was "no legislative history or case law that the [State] General Assembly intended a different reading of the statute." In re Sikes, No. 04-30951(2), 2004 WL 2028021, at *3 (Bankr. W.D. Ky. 2004); See also In re Lawrence, 205 B.R. 115 (Bankr. E.D. Tenn. 1997) aff'd, 219 B.R. 786 (E.D. Tenn. 1998). In Utah, on the other hand, there is clear case law upholding the state's long history of allowing wage exemptions in bankruptcy. See In re Stewart, 32 B.R. 132 (Bankr. D. Utah 1983).

Moreover, for every case that the Trustee cites to support his proposition, there are just as many, if not more, finding that state garnishment statutes create wage exemptions in bankruptcy proceedings. See, e.g., In re Robinson, 241 B.R. at 451; In re Urban, 262 B.R. at 869-71; In re Irish, 311 B.R. at 66-67; In re Stewart, 32 B.R. at 139; In re Jones, 318 B.R. at 847; In re Haraughty, 403 B.R. 607, 612-14 (Bankr. S.D. Ind. 2009).

Controlling authority in this jurisdiction has long held that "exemption statutes are liberally construed in favor of the debtor." Russell M. Miller Co. v. Givan, 325 P.2d 908 (Utah 1958). See also Carbaugh v. Carbaugh (In re Carbaugh), 278 B.R. 512, 522 (10th Cir. 2002) ("Exemption statutes must be liberally construed so as to give effect to their beneficent purposes."). The Utah Supreme Court has "historically deferred to the interests of debtors by liberally

construing ambiguous exemption statutes in their favor." In re Kunz, 2004 UT 71, ¶10, 99 P.3d 793, 795 (Utah 2004). Therefore, instead of adopting a ruling that is contrary to Utah's public policy and long history of protecting debtors' rights, this Court should uphold Utah's legislative intent that wage exemptions apply in bankruptcy.

The Trustee also argues that the Utah legislature must have intended wage exemptions to be unavailable in bankruptcy because the Utah statute states that "definitions or terms used [in the Utah Consumer Credit Code] have the same meaning as terms used in [the CCPA]". Aplt. Brief at 13; Utah Code Ann. § 70C-1-301. However, the Utah Consumer Credit Code never goes so far, as the Trustee suggests, as to incorporating cases interpreting the CCPA. Nor can the Trustee point to any Utah legislative history to support his theory that Kokoszka's ban on wage exemptions in bankruptcy was adopted under Utah law.

Finally, the Trustee argues that the Utah legislature intended to overturn Stewart by amending the Utah Consumer Credit Code two years after Stewart was decided. See Aplt. Brief at 12-13. In Stewart, the court gave a thorough history of wage exemptions under Utah law and specifically held that "the Utah legislature did not intend to deprive debtors in bankruptcy of an exemption in wages." In re Stewart, 32 B.R at 137. If the Utah legislature intended to overturn Stewart, and deprive wage exemptions in bankruptcy, it would have done more than merely

model the Utah Consumer Credit Code after the CCPA. To assume otherwise, without the support of any affirmative statutory language or legislative history, as the Trustee does in this case, ignores the long history of the State of Utah and the mandate that "exemption statutes are liberally construed in favor of the debtor." Russell M. Miller Co. v. Givan, 325 P.2d 908 (Utah 1958). Therefore, like its predecessor laws and statutes which limited wage garnishment, the Utah Consumer Credit Code creates an exemption in bankruptcy.

B. Utah Code Ann. § 70C-7-103 Does Not Need to Fully and Permanently Sequester Wages in Order to be Considered an Exemption Statute.

The Trustee argues that for a wage exemption statute to exist, it must provide for full and permanent sequestration of wages from creditors. However, there is no credible legal authority to support the Trustee's assertion. The Trustee bases his argument on a new "test" created by the court in In re Lawrence that a true exemption statute requires a debtor to be able to completely and permanently sequester property to himself by prohibiting creditors from ever using the judicial process to obtain it. See 219 B.R. at 793-94. Therefore, according to the Lawrence court, the statute limiting garnishment of wages is not a true exemption statute because the wages are not also exempt after they are paid to the debtor. See id. However, the Lawrence court cites no support for its theory or a basis for this new "test".

Based on In re Lawrence, the Trustee makes much of the fact that Utah Code Ann. § 70C-1-103 does not refer to protection from other specific collection actions such as "attaching, seizing and executing on the property". Aplt. Brief at 14. However, what the Trustee failed to note was that "garnishment" is a defined term under the Utah Consumer Credit Code, and it means "any legal or equitable procedure through which the earnings of an individual are required to be withheld for payment of a debt." Utah Code Ann. § 70C-7-103(a)(b) (emphasis added).

Moreover, the fact that earnings are not shielded from all forms of process in a garnishment statute does not indicate that it is not an exemption statute. See In re Haraughty, 302 B.R. 607, 610 (Bankr. S.D. Ind. 2009). "Unlike other assets that might be subject to levy, unpaid wages are neither in the possession of the debtor nor owned by the debtor," therefore the absence of references to assignment, attachment, levy execution and seizure is unnecessary in the garnishment of wages provision, since those forms of process are inapplicable to protection of wages. Id. See also In re Mayer, 388 B.R. 869, 872 (Bankr. N. D. Ind. 2008). Therefore, the term "garnishment" under the Utah Consumer Credit Code is broad enough to cover the specific remedies cited by the Trustee.

The Trustee also argues that Utah Code Ann. § 70C-7-103 is not a true exemption statute because it does not permanently sequester the wages from creditors once they are in the hands of the debtor. See Aplt. Brief at 14. Although

the Trustee is correct that the exemption under the statute is temporary, there are other recognized exemptions under Utah law that are temporary in nature, such as workers compensation benefits under Utah Code Ann. § 34A-2-422. The Trustee's proposed test would also result in a determination that Utah's homestead exemption statute is not a true exemption statute because it does not permanently sequester property from creditors. Under Utah's homestead exemption statute, as with many exemption statutes, the protection from creditors can vary depending on the form the property takes. For example, a debtor may lose the higher exemption amount if the real property is no longer the "primary personal residence" of the debtor. Utah Code Ann. § 78B-5-503(2). Likewise, if the real property is sold the proceeds are exempt only for a limited duration, one year. See Utah Code Ann. § 78B-5-503(5)(b). Therefore, the temporary nature of the wage garnishment statute is irrelevant in determining whether it provides an exemption. See In re Haugherty, 403 B.R. at 611.

II. PRE-PETITION WAGES IN THIS CASE ARE DISPOSABLE EARNINGS.

The Trustee argues that pre-petition wages are not "disposable earnings" because "earnings" are limited to periodic payments of compensation and the Debtor's pre-petition wages were payable in a lump sum. However, "earnings" under the Utah Code are defined very broadly as "compensation paid or payable" for "personal services," "whether denominated as wages, salary, commission,

bonus, or otherwise, and includes periodic payments pursuant to a pension, retirement," or disability program. Utah Code Ann. § 70C-7-302(4). There is no restriction that earnings cannot be paid in a lump-sum, nor is there a requirement that all compensation must be paid on a periodic basis. See Utah Code Ann. § 70C-7-302(4).

The Trustee relies on a Utah case that found that tax refunds are not considered earnings because tax refunds are nonperiodic in nature. See Funk v. Utah State Tax Comm'n, 839 P.2d 818, 821 (Utah 1992). However, here we are concerned with the Debtor's earned but unpaid periodic wages, not a tax refund. This Court in Funk found that tax refunds were not disposable earnings because "[w]age earners do not rely on tax refunds as a means of support to the same extent that they rely on periodic payments of compensation....[and] most people do not budget tax refunds into their regular living expenses." Funk, 839 P.2d at 821.

Unlike the tax refunds in Funk, the pre-petition wages in this case were accumulated based on employment contracts between Debtor and Douglas Reinhart, M.D., P.C., his employer. See Aplt. App. at 109-112. The employment agreements provided compensation to the Debtor for the performance of his services under the contract, payable monthly. See id. In addition to the monthly salary, the employment agreements provided for a $5,000 per year bonus. See id. Thus, even under the Trustee's narrow construction of the statute the wages at

issue in this case are "earnings" under the Utah Consumer Credit Code because the amounts owed were periodic in nature per the employment agreements.

Moreover, several courts have found that the proper test for determining whether payments are considered "earnings" is whether the payments were for compensation payable for personal services, and not whether the payments were periodic in nature. See Genesee County Friend of Court v. General Motors Corp., 626 N.W.2d 395, 400-01 (Mich. 2001); See also In re Pruss, 235 B.R. 430, 433 (B.A.P. 8th Cir. 1999) (finding that definition of earnings was broad enough to encompass and protect an attorney's accounts receivable to the extent they were payment for personal services.); BancOhio Natl. Bank v. Box, 580 N.E.2d 23, 25 (Ohio Ct. App. 1989) (finding that commissions were earnings based on the sole criteria for exemption under the CCPA that the earnings subject to garnishment represent compensation for personal services.); In re Jones, 318 B.R. 848-50 (Bankr. S.D. Ohio 2005) (an independent contractor's earnings owed to him from his occupation as a self-employed contractor in the lump sum of $25,000 were considered "disposable earnings" and therefore exempt from garnishment.).

For example, the Court in Genesee found that signing bonuses, profit-sharing payments, and recognition-award payments all constituted earnings. See 626 N.W.2d at 400-01. The court also stated that the reference to periodic payments did not apply to the definition of "earnings" as a whole but instead

simply modified the words "pursuant to a pension, retirement" or disability program. Id. at 401. Specifically, the inclusion of "bonus" in the definition of earnings clearly negates the suggestion that periodic payments are required since bonuses are typically sporadic, irregular, unpredictable and discretionary payments by the employer. Shah v. City of Farmington Hills, 748 N.W.2d 592, 596 (Mich. App. 2008). Therefore, the Debtor's unpaid wages that he earned by providing personal services pursuant to an employment contract prior to the petition date are considered "disposable earnings" under Utah Code Ann. §70C-7-103.

III. THE DEBTS AROSE FROM A CONSUMER CREDIT AGREEMENT

The Trustee's final argument is that the pre-petition wages do not meet the "consumer credit agreement" language contained in the Utah Consumer Credit Code. See Aplt. Brief at 17. The Trustee's argument hinges on the following assumption: that "the Trustee will pay with the Pre-petition Wages, according to the priorities in the bankruptcy code, debts that arose from transactions that are not covered by § 70C-7-103." Aplt. Brief at 17-18.

However, this assumption lacks a factual basis because the Trustee never offered, nor obtained the admission of, evidence concerning what debts the Trustee "will pay" with the pre-petition wages. Id. Moreover, the foregoing assumption incorrectly presumes, without any legal authority whatsoever, that the issue of what debts a trustee "will pay" is dispositive as to whether a "judgment aris[es]

from a consumer credit agreement" in the bankruptcy context. Utah Code Ann. § 70C-7-103(2). For example, the Utah Consumer Credit Code could just as easily be interpreted to apply to bankruptcy cases in which the majority of the scheduled debt is consumer-related, as in this case. (Aplt. App. at 36) (voluntary petition identifying nature of debts as "Consumer/Nonbusiness"); (Aplt. App. at 56 & 60) (indicating consumer related debts consisting primarily of mortgages and student loans in the amount of $212,629.61); (Aplt. App. at 171, II. 14-17; & 56) (Trustee's counsel admitted on the record that the mortgage debts were "consumer credit transactions under the [Utah] code"); (Aplee. Supp. App. at 1) (proof of claim was filed by the "Consumer Loan Collection Center" for $6,647.19).

Such an interpretation would also prove more workable than the Trustee's suggestion because the determination of what claims the Trustee "will pay" cannot fully be made until the end of a chapter 7 bankruptcy case, causing uncertainty for all parties involved. The record in this case shows that the debts are "primarily for personal, family, or household purposes," and therefore the Utah Consumer Credit Code applies to this case. Utah Code Ann. § 70C-1-201. Thus, the Court should reject the Trustee's unsupported assertion that a debtor's ability to exempt earnings under the Utah Consumer Credit Code is dependent upon the claims a trustee "will pay," and should find that the debts are from a "consumer credit agreement" because the debts are primarily for personal, family, or household expenses.

CONCLUSION

As set forth above, all three issues certified to this Court by the Tenth Circuit Court of Appeals should be decided in favor of the Debtor. This Court should uphold its long history of construing exemption statutes liberally in favor of debtors and should find (1) that Utah Code Ann. § 70C-7-103 creates an exemption in bankruptcy, (2) that the Wages are "disposable earnings" under said statute, and (3) that § 70C-7-103 applies because the debts in this case are primarily for personal, family, or household purposes.

DATED this 7th day of September, 2011.

/s/ Duane H. Gillman

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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing **REPLY BRIEF OF APPELLEE** was served this 7th day of September, 2011, via searchable PDF on CD and via regular U.S. mail, postage prepaid upon the following:

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